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UNRESTRICTED STATE REVENUE SHARING IN MICHIGAN

Michigan state government for a number of years has shared with cities, villages, townships, and counties (hereafter referred to as "local governmental units"), the revenues from the sales tax, the intangibles tax, the income tax, and the single business tax. This is known as unrestricted state revenue sharing (as opposed to state aid restricted for specific purposes or school aid). In fiscal year 1992-93, state revenue sharing transferred over \$1.0 billion from the state to these local governmental units.

States generally share revenues with local governments to serve two purposes: to directly aid local governments by providing revenues in addition to local taxes and to indirectly aid local taxpayers by relieving local tax burdens. As reported in the 1971 Economic Report of the Governor, "The state's objective in sharing this revenue with these local governments is to better enable these 'creatures of the state' to provide needed services for their residents." Michigan state revenue sharing has also been a means for the state to reimburse local governmental units for local taxes preempted by state taxes.

All 1,859 local governmental units in Michigan, including all 273 cities, 261 villages, 1,242 townships, and 83 counties, are entitled to some unrestricted state revenue sharing based on their population. For the purpose of state revenue sharing, the population of each local governmental unit is based on the federal census, adjusted for "persons who are wards, patients or convicts in any tax supported institution. "Some local governmental units receive more state revenue sharing than others due to their higher "relative tax effort." Because it is "unrestricted," local governmental units are free to utilize state revenue sharing as they see fit. In addition to this unrestricted aid, local governmental units receive state aid for specific purposes (such as highways or mental health).

State Revenue Sharing as a Component of State Spending

State revenue sharing comprises a major proportion of state spending in Michigan. Unrestricted state revenue sharing generally comprises about eight percent of total state spending -- in fiscal year 1993, \$1.0 billion of the \$12.8 billion in total state revenues from state sources. In addition, unrestricted state revenue sharing generally comprises about one-fifth of the state spending mandated by Section 30 of Article 9 of the Michigan Constitution, which requires that the proportion of total state spending paid to all local governments as a group shall not be reduced below 41.61 percent. Shifting funds from state revenue sharing to school aid will not adversely affect the state's compliance with this constitutional mandate, and any significant increase in state school aid funding, as is being discussed, will place the state well over the minimum requirement.

How Does Michigan Compare?

Michigan shares more revenues per capita with local governmental units than many other states.

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As reported by the U.S. Advisory Commission on Intergovernmental Relations (ACIR) for fiscal year 1991, Michigan ranked as the 16th highest state in per capita intergovernmental expenditures (\$703), but \$38 less than the national average (\$741). Michigan ranked as the tenth highest state in per capita expenditures (\$110) for general revenue sharing among the 47 states that have some form of general revenue sharing, \$43 more per capita than the national average (\$67). Michigan ranked 38th in per capita expenditures (\$337) to local units of government for all education purposes, \$84 per capita less than the national average (\$462).

State Revenue Sharing Components

The state revenue sharing system has evolved since 1939, growing from \$1.9 million, the first year that intangibles tax revenue was shared, to over \$1.0 billion in fiscal year 1993. Changes have affected the amount of the tax revenues to be used for revenue sharing (the size of the pie) and the distribution of this revenue among the governmental units (how the pie is sliced). Current provisions for the state revenue sharing system are contained in the state revenue sharing act, Public Act 140 of 1971, as amended. A history of the four state taxes that are a source of revenue sharing provides an understanding of how the system has evolved.

<u>Revenues</u>	<u>Millions of Dollars</u>	<u>Percent</u>
Sales Tax	\$424.2	41.1
Income Tax		
Municipalities	(224.0)	(21.7)
Counties	(121.6)	(11.8)
Subtotal	345.6	33.5
Intangibles Tax	0.0	0.0
Single Business Tax		
Relative Tax Effort	153.5	14.9
Inventory		
Reimbursement	109.2	10.6
Total State Revenue Sharing	\$1,032.5	

Intangibles Tax

The intangibles tax is a tax imposed upon the ownership of intangible personal property, including items such as stocks, bonds, and monies on deposit. It is collected by the state in lieu of taxing such property at the local level under general property tax laws. Ordinarily, \$9.5 million of intangibles tax revenues is distributed on a per capita basis to each city, village, and township levying at least one mill of local property tax in the preceding year. In fiscal year 1993, no intangibles tax revenues distributions occurred due to the shifting of the date of distribution from one state fiscal year to another. In fiscal year 1992, \$9.5 million comprised only eight percent of total intangibles tax revenues.

Prior to 1939, local governmental units had jurisdiction to tax intangible property, but only a few cities made a real attempt to assess this type of property completely due to the lack of knowledge on the part of assessors as to who held intangible property and to the administrative costs involved. In 1939, the state exempted intangible personal property from the local property tax by statute and taxed it under this specific tax. The act provided that two-thirds of the tax revenues were returned to the cities, villages and townships on a per capita basis and one-third was kept for state purposes.

The intangibles tax act was amended in 1945 to return 100 percent of the revenues to the cities, villages and townships, but subsequent amendments have reduced the portion of the tax revenues that are returned to these governments. In 1951, the state capped the intangibles tax distribution at \$11.0 million to offset the loss of state revenues resulting from the earmarking of the sales tax.

This cap was lowered to \$9.5 million in 1952. The amount shared with local governmental units was increased with the passage of the state revenue sharing act in 1971 but returned to \$9.5 million in 1975 with the enactment of the single business tax and the repeal of the tax on business intangible property. The single business tax makes provisions for reimbursing local units for the loss of business intangibles tax revenues.

Sales Tax

The state Constitution provides for revenue sharing from sales tax collections. It requires that 15 percent of the gross collections be shared with local governmental units on a per capita basis. Sales tax revenue sharing can be changed only by constitutional amendment.

Sales tax revenues have not always been constitutionally earmarked for local governmental units. In 1933, the state property tax was reduced as a means of freeing available millage for local governments and the sales tax was enacted to provide additional state revenues. At times, the state was able to make legislative grants to local governments when the Legislature felt there were adequate revenues to share with local governments.

In 1946, an initiated constitutional amendment was adopted, the "Sales Tax Diversion Amendment," which earmarked a portion of sales tax revenues for local governmental units and for schools. It required that one-sixth of the then three-cent sales tax revenues be distributed among cities, villages and townships on a per capita basis. The 1963 Michigan Constitution, which set a four percent limit on the sales tax rate, provides in Section 10 of Article 9 that:

One-eighth of all taxes imposed on retailers on taxable sales at retail of tangible personal property shall be used exclusively for assistance to townships, cities and villages, on a population basis....

The required distribution remained at one-eighth (12.5 percent) until a 1974 amendment to the state Constitution exempted food and prescription drugs from the sales tax base. The allocation of sales tax revenues to local governmental units was increased to a total of 15 percent of collections to compensate these units for the loss of revenues resulting from the exemptions. In fiscal year 1993, local governmental units received \$424.2 million from sales tax revenue sharing, or \$46.27 per capita.

State Income Tax

In 1967, the state income tax was enacted to increase state revenues. Cities had been levying city income taxes since 1961, and in 1964, the state adopted a local option uniform city income tax act to provide a local revenue source. There was concern at the time of enactment of the state income tax that it might preempt cities from levying local income taxes. In order to win approval for the tax package, the state agreed to share state income tax revenues with local governmental units. The act provided that 17 percent of the net collections (or about 11.5 percent of gross collections) from individuals at the then 2.6 percent rate was to be distributed among local governmental units, with one-half distributed on a per capita basis among counties and one-half distributed among cities, villages and townships on a per capita basis.

Amendments have altered the amount of revenues shared with local governmental units and the split of these revenues between the counties and cities, villages and townships. Present law pro-

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vides that 6.91 percent of the gross state income tax collections (at the current 4.6 percent rate) be distributed to local governmental units. Of the total amount for local governmental units, 34.65 percent is directed to counties on a per capita basis and 65.35 percent is distributed to cities, villages and townships on the basis of relative tax effort and population. In fiscal year 1993.. \$345.6 million from state personal Income tax revenues was shared with local governments: \$121.6 million to counties and \$224.0 million to cities, villages and townships.

Relative Tax Effort In 1971, Michigan began using relative tax effort as the basis of distributing state income tax revenues to cities, villages and townships in an attempt to address the great differences among local units in their need for public services and in their tax bases and tax rates. Relative tax effort is the local tax effort rate, which includes property taxes, income taxes, utility users excise taxes and special assessments levied on an ad valorem basis by a local government, divided by the statewide tax effort rate (the average tax rate for all local governments). Presently, state income tax and some single business tax revenue distributions to cities, villages and townships are based on the relative tax effort and population. Relative tax efforts for individual local units in fiscal year 1993 range from 6.8 for the City of Detroit, meaning Detroit has a tax effort 6.8 times the state average (1.0), to 0.0 in 11 townships and one village which have no local taxes.

Single Business Tax

The single business tax was established in 1975 to replace eight state and local taxes on business, including the property tax on inventories, and the business portion of the intangibles tax (as noted, intangible personal property had been exempted from local tax and made subject to a state tax in 1939). The state, in replacing these local taxes, agreed to reimburse cities, villages, townships, counties and authorities for the loss of this local revenue. In addition to these direct reimbursements, cities, villages and townships also share in the growth of the single business tax.

Cities, villages, townships, counties and authorities are reimbursed for the loss of local property taxes on inventory. The reimbursement each year is based on the tax rate in the prior year times the state equalized value of inventory property in the local governmental unit in 1975. This method of reimbursement is based on antiquated inventory assessments that bear no relationship to inflation, to economic changes over the past 18 years, or to variations in growth in different local governmental units over this time. In fiscal year 1993, local governmental units that had been taxing inventory properties prior to the 1975 enactment of the single business tax were reimbursed a total of \$109.2 million.

Revenues from growth of the single business tax and the reimbursement for the repeal of the business portion of the intangibles tax are distributed among the cities, villages and townships using the state revenue sharing relative tax effort formula. In fiscal year 1993, local units received \$153.5 million from these components of single business tax revenue sharing. Approximately 14 percent of gross single business tax revenues are shared with local governments, a total of \$262.7 million in fiscal year 1993.

Payment History to Local Units

Statutory revenue sharing distributions (excluding the constitutionally-mandated sales tax revenue sharing) have been subject to the vagaries of state budget cycles, including legislative budget cutting during the past two recessionary periods. In the early 1980s, several executive orders reduced and eliminated payments to local governments from each of the three statutory taxes. In

the early 1990s, as well, executive orders and public acts resulted in reductions in payments from each of these taxes for specific years. In addition, due to one-time expenditure adjustments, the timing of payments to local governments has been shifted from one state fiscal year to another so that payments can be eliminated in one of those years. These payment reductions and eliminations have resulted in the sharing of less revenue with local governments and the retention of more revenues than otherwise would have been the case for state purposes.

Effect on Local Revenues

Every county, city, village, and township in Michigan has benefited from unrestricted state revenue sharing. In fact, 935 of the cities, villages and townships (53 percent) received more state revenue sharing distributions than they collected through local taxes in fiscal year 1993. Clearly, the largest recipients of state revenue sharing are the most populous local governmental units and those with the highest relative tax effort. Detroit receives the most state revenue sharing per capita (\$249), over \$62 per capita more than Highland Park (\$186), the second highest, and more than double the state average per capita distribution (\$111). The 50 most populous cities and townships, which comprised 45 percent of the state population, received 61 percent of the city, village and township 1993 total state revenue sharing distribution.

While state revenue sharing has greatly enhanced revenues in some local governmental units, it has also created a system of dependency for many of these units. Some local governmental units rely on state-shared revenues for a large percentage of their revenues, while others are much less dependent. Local governmental units of all sizes are found on both ends of this spectrum. According to the Michigan Municipal League, state-shared revenues account for over 15 percent of total city and village revenues.

If unrestricted state revenue sharing is eliminated, local governmental units would have to increase their local millages to make up for this lost revenue or cut local spending. Cities, villages and townships would have to increase their millages by an average of 6.7 mills to make up for the loss of all 1993 state revenue sharing. The increase would average 3.9 mills if only statutory revenue sharing is eliminated, and sales tax revenue sharing remains unchanged since it is constitutionally mandated. **Table 2** is an array of the cities, villages and townships by the number of mills that would be necessary to replace 1993 statutory state revenue sharing. Counties would have to increase their millages by an average of 1.0 mill to make up for the loss of 1993 state revenue sharing. The loss of state revenue sharing would be quite serious to many communities, with the largest increase necessary in the City of Benton Harbor, which would have to increase its levy by 67 mills to replace 1993 income tax and single business tax revenue sharing or 97 mills to replace all 1993 state revenue sharing. **Table 3** is a list of the 15 cities and villages that would have to increase their millages the most to make up for the loss of 1993 state revenue sharing. Any increase in county millages would be in addition to the figures shown.

Table 2
Cities, Villages & Townships
Mills Required to Replace
Statutory State Revenue Sharing
FY1992-93

<u>Millage Increase</u>	<u># Units</u>
50.0+ mills	1
20.0 mills to 49.9 mills	2
10.0 to 19.9	5
5.0 to 9.9	105
1.0 to 4.9	425
0.1 to 0.9	1,223
0.0	15

State revenue sharing receipts tend to be equal to about 45 percent of the property tax levy of local units. While local governmental units received over \$1.0 billion in 1993 state revenue sharing, the 1993 property tax levy collected by these units totaled over \$2.5 billion.

Shared state revenues also have an impact on the bond ratings of local governmental units in Michigan. In addition to using state revenue sharing for the operations of local government,, some local governmental units have pledged future state revenue sharing to guarantee capital bonds. Deficit funding bonds have also sold with the promise that future state-shared revenues will be available to make up for current deficits.

Summary

State revenue sharing shifts the burden of collecting taxes from the local governmental units to the state, while providing revenue to local governments. it also tends to equalize resources and neutralize disparities among local governmental units. Some argue that state-shared revenues violate a bedrock principle of responsible governments that responsibility for raising money should accompany the spending of it. Others argue that state revenue sharing protects the ability

of local governments to provide services by directly aiding local governments and indirectly aiding local taxpayers. The intangibles tax, income tax, and single business tax are all state taxes that preempted local taxes, and it was agreed at the time of enactment of these state taxes that local governments would be reimbursed for the "loss" of these revenues.

Table 3
Most Severely Impacted Cities and Villages
Property Tax Rates Required if State Revenue
Sharing Were Eliminated
FY1992-93

	1993 Actual <u>Millage</u>	Millage After <u>Increasing to Replace</u>	
		Statutory Revenue <u>Sharing</u>	All Revenue <u>Sharing</u>
Benton Harbor	34.16	101.14	130.88
Detroit	32.73	69.35	77.72
Hamtramck	28.53	49.13	56.59
Highland Park	27.97	40.81	45.05
Pontiac	29.25	42.04	46.59
Calumet	24.25	35.68	43.65
Gaastra	21.97	32.42	43.05
Muskegon Hts	15.85	25.87	33.01
Springfield	15.95	25.82	31.18
Mineral Hills	22.00	31.72	40.98
Laurium	21.50	31.10	41.32
Ishpeming	26.46	35.76	42.74
Saginaw	11.88	21.14	26.98
Bloomington	10.94	20.15	27.31
Ecorse	31.83	40.74	44.18
City Average	15.79	20.96	24.03
Village Average	12.47	14.80	18.04
Township Avg	3.45	3.94	6.27